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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Prioritise retirement over leaving an inheritance

Providing enough resources for your children while, at the same time, taking care of your own financial future can be a difficult balancing act. And while many parents would like to leave an inheritance, this might not always be feasible, especially during uncertain economic times where finances are stretched. According to retirement income specialist Just SA, the desire to leave a financial legacy can be an emotional subject for parents; and could even negatively impact their own retirement plans. Heather Bell, Business Development Manager at Just SA, and a mother of three, says it's important for parents to prioritise their own financial future so they don't become a financial burden on their children as they age.

"Not only are we living a lot longer these days, but life is expensive. This makes it difficult to save as much as you might want to, which can lead to the risk of running out of money in retirement and increasing the possibility of leaning on your children to help with your expenses later in life." One way to avoid this is to start as early as possible to educate your children about the financial realities of your household – what is affordable for your family, and what isn't. The next step, Bell says, is to help them distinguish between wants and needs. "In our family, as parents we provide for our children's needs; but they are encouraged to acquire the means to provide for their wants themselves. This can make for some very interesting discussions when your children try to convince you that something they want is really something they need!"

Food, shelter, education and medical care are some of the needs that parents should cover. But when it comes to the latest toys, gadgets or fashion, these are good examples of items that are 'wants'. While you may strive to give your children everything they ask for, it's not always worth overspending at the expense of your own financial future, or at the risk of showing your children, incorrectly, that unnecessary spending is fine. Pocket money, rewards for getting good grades, and extra money from birthdays and other celebrations are all potential sources of income for young children. And as they get older, you can encourage them to seek part-time work to help support the family financially.

"Of course, some treats or 'wants' may occasionally fall within your budget as a parent, but it's important to draw firm, consistent lines on what you can and can't buy, and what is an everyday expense and what is a treat," Bell adds. Finding a healthy balance between looking after yourself and looking after your children is the goal. Even if your children won't mind looking after you in your golden years, having financial independence is empowering and can lead to less stress in your relationships with your adult children. The decisions you make now will help you achieve a balanced outcome. It will also determine the healthy habits you instil in your kids which, in turn, will create a legacy in how they view and use money. It's a good idea to work with a financial adviser to reassess your current personal financial situation regularly, and to revisit your retirement goals as your needs change. Keep in mind that a general rule of thumb is to plan to have enough income to support yourself in retirement for about 30 years: to age 95 if you're male and age 100 if you're female, as females tend to live longer.

"Instead of scrimping and saving throughout one's adult life to leave money for your children, at Just SA we suggest parents rather focus on reducing their risk of depending on their loved ones in their golden years," Bell says. "Once you know you have enough, then any additional funds or assets you might have can go to your children." When you retire, retirement legislation requires that you use at least two thirds of your savings to buy an income-generating product, such as a life or a living annuity. There are pros and cons involved and it is important to assess all your options, preferably with a financial adviser, to ensure you make an informed decision.

FA News | 3 August 2023

Securities can boost your family's nest egg - The magic of dividends for passive income

Due to the rising prices of food and transport over the last few years, South African investors have seen an increase in the cost of living, as measured by the consumer price index (CPI). Inflation erodes the purchasing power of money and reduces the value of the assets you have available to support you once retired, thus negatively impacting your financial freedom. Growing a meaningful 'nest egg' is a necessary step towards achieving your financial goals, ensuring that you can enjoy your retirement years and position yourself to withstand the negative impact of inflation on your lifestyle.

What is meant by a 'nest egg'?

A nest egg refers to a bundle of financial assets saved over time with the aim of providing a passive income for you and your family in retirement and enabling you to choose a work schedule that suits your future health and lifestyle needs. A common and unfortunate misconception is that investing is exclusively for the rich (based on the inaccurate belief that building wealth requires a sizeable amount of money). However, the reality is that successful investment outcomes are accessible to those who understand that time is a critical factor when building wealth. It is not down to the amount of money being invested alone. This is especially relevant when considering adding securities to your family's nest egg, as they have consistently proven to beat inflation over the long-term more effectively than any other single asset class. Most of those who consistently invest in securities over the long term are better placed to enjoy their retirement with far less negative impact on their lifestyles.

How investing in securities contributes towards passive income

Investing in securities over the long term generates both capital gains and dividend income. Capital gains are enjoyed when the value of a share exceeds the initial cost of purchasing the share, whilst dividend income is a financial return investors receive whilst holding **securities**, in other words securities not only provide a financial benefit once they are sold (by way of capital gains), but also provide regular benefits whilst you are invested in them (by way of dividends). Receiving dividends every quarter or every year is an excellent passive income source and hence a key asset class to consider as part of your nest egg. An added benefit of earning dividend income whilst you are contributing towards retirement is that it provides an opportunity to reinvest these funds into securities when they are attractively priced, in turn increasing your ability to generate further dividends in the future. Receiving dividend income during your retirement also limits the need for you to sell shares to fund your expenses (which would trigger capital gains tax).

Factors to consider when adding securities to your portfolio

There are different ways of incorporating securities into your family's nest egg:

Shares and exchange traded funds (ETFs) listed on the JSE

Investors can enjoy exposure to shares listed on the JSE through a direct equity portfolio which provides exposure to an index or portfolio of stocks (for example ETFs) or a single share (affording exposure to a particular sector of the economy). Both ETFs and shares provide passive income in the form of either distributions paid quarterly (in the case of ETFs) or dividend income paid bi-annually (in the case of locally listed shares).

Shares and exchange traded funds listed on offshore exchanges

Investors can diversify their exposure by not only investing locally (in 'SA Inc.' shares), but also **investing in shares offshore**. Individual investors have various means to invest in offshore shares and ETFs, the most common method being investing using their annual single discretionary allowance (currently R1 million per calendar year), whilst investors making use of trusts or companies to house their offshore investments can also make use of institutional investor facilities. Investing in offshore securities can contribute meaningfully towards your family's nest egg, but I would encourage seeking assistance from a qualified financial adviser to guide you along the way.

Personal Share Portfolios (PSPs)

A final option is investing in local and offshore shares through a PSP. The benefit of a PSP is that it allows you to structure your retirement funds in such a way that you can invest directly in shares. No capital gains tax or income tax is payable within a retirement annuity, so you can have direct exposure to shares without the tax implications associated with a separate direct equity portfolio. Regulation 28 of the Pension Funds Act currently limits equity exposure in retirement funds to 75% (whether local or offshore), exposure to local or international property to 25%, and foreign investment exposure to 30%. There are also additional restrictions, including sub-limits for alternative investments and the percentage of a portfolio that can be held in offshore assets.

Holistic financial advice

Since retirement planning requires holistic financial advice, it is advisable to consult a financial adviser to ensure your family's nest egg is well positioned to deliver on your needs.

FA News | **3 August 2023**

Former government employees cry foul over pension payouts

Scores of former government employees across the country will be heading to court to challenge their exclusion from pension redress.

The retired civil servants served the government for decades while in the employ of the former homelands and the South African government. However, they said during the apartheid era they were discriminated against on the basis of race, gender and employment status in relation to pension benefits. Deputy chairperson of the Civil Servants Pension Redress Movement (CSPRM), Stephen Sass, said tens of thousands of disgruntled former health workers, teachers, policemen, soldiers and government employees were now being discriminated against again as they had been pushed out of the redress process.

The CSPRM was established in Swellendam in May 2019 to address the concerns and has members across the country and in Namibia. Sass said that in 1996 the government consolidated all pension funds of the Transkei, Bophuthatswana, Venda, Ciskei and South Africa into an umbrella body called the Government Employee Pension Fund (GEPF). Two years later an attempt was made to redress the pension injustices before 1994 by compensating former employees who had retired with one lump sum of money and also readjust pensionable years that were not covered during the apartheid dispensation.

“Billions of rands were set aside to compensate government employees who had been in service on 2 September 1998. But many former employees say they were not informed about the programme and the deadline also excluded many who previously suffered discrimination,” said Sass. He said that some pension payouts were miscalculated and of the 157 000 people who applied for redress, only 54 000 were deemed to qualify. The organisation was also in the process of gathering more affected former employees. Sass addressed more than 800 former employees in Gugulethu last week and scheduled to set up a provincial meeting on August 5 in Worcester.

Leader of the United Democratic Movement (UDM) Bantu Holomisa also raised the frustration of the former government employees. During his State of the Nation Address (Sona), President Cyril Ramaphosa tasked the Minister of Finance with setting up a task team to look into pension redress matters. Holomisa said: “I met with Minister Godongwana on 22 March and he promised to meet with the various committees representing the affected former employees. None of the promises that came afterwards materialised. We’ve been left with no other option but to approach the courts.” He said attorneys have been briefed and senior counsel advocate Tembeka Ngcukaitobi had also agreed to represent them.

According to Holomisa, the former workers were employed in the 1970s and 1980s. Finance Minister Enoch Godongwana said a process to verify the validity of the claims was being undertaken by insurance companies Sanlam and Alexander Forbes. “There are two categories of people. On the one hand, there are those whose pensions were transferred to GEPF but claim that the value of their pension was miscalculated. Those were mainly in the former Transkei and Ciskei. On the other hand, some former employees in Venda opted to keep their contributions with Sanlam and never transferred them to GEPF. “But we have asked all these pension funds to verify the validity of the claims. They are busy processing about 30 000 claims,” said Godongwana.

IOL | 29 July 2023

INTERNATIONAL NEWS

Why investing pension funds requires players to think outside the box

It's a tough time to be investing a pension fund's cash. Analysis of pension schemes by Actuarial Service East Africa (ActServ) shows overall flat returns over the first quarter this year (0.8 percent) and 2022 (-0.6 percent). Both returns further trail those posted in the first quarter of 2021 and 2019 at 2.26 percent and 6.5 percent respectively. In addition, for the year 2022, weighted average returns stood at 1.7 percent - while inflation in the period averaged 7.64 percent. Amid this pressure, there's a need to be creative. With treasuries yielding higher, there's a strong urge to allocate here – 77 percent of pension funds were in fixed income in Q1 2023, up from 76.5 percent in Q1 2022.

But for long-term reasons, they may need to search for credible high-yielding alternatives. Should they turn to alternatives for help? I think so. Here's why: I refer to a recent study commissioned by the American Investment Council on Private equity (P.E) returns by public pension funds. The research, which tracked their performance in the period between 2012 and 2021, found that their private equity allocations delivered greater net fee returns than returns from publicly traded stocks. In addition, it showed about 85 percent of the public pensions had some exposure to private equity with an average allocation of 8.5 percent.

In summary, the study demonstrated that long-term commitments in this asset class enabled pension schemes to deliver on their mission to provide retirement security for their pensioners. Why this asset class? One, it's one of the alternative asset classes available to pension funds. Since 2016, the retirement benefits authority (RBA) has allowed its pension schemes to invest up to 10 percent of their assets under management in this class. However, investment to date totals less than one percent compared unfavourably to Uganda which has a 2.2 percent commitment from its pension funds. Nonetheless, the journey has begun.

Two; Kenya is a hub for many private equity operations within the region and already attracts huge allocations from foreign private equity capital compared to the region. Three, with private markets increasing their role in capital formation, it is important that pension funds have access to these investments. They not only help diversify their portfolios but help provide critical capital to small and medium-sized enterprises and support jobs, all the while generating impressive long-term returns. Now, considering most pension schemes have asset values of less than Sh1 billion, an allocation of 10 percent to private equity or Sh100 million would not meet the minimum investment threshold for most private equity funds. In that case, a fund of funds (FoF) model is ideal where capital is aggregated from smaller schemes and into a single pool. Commitments are thereafter made to a number of private equity partnerships. Research by FSD Africa supports the above model as FoFs boast long-standing relationships with many private equity managers and have good knowledge of the investment landscape. This is useful as it would address the expressed reservations of Kenyan pension scheme trustees on the lack of directly available benchmarking and performance data. Ultimately, in order to offer retirement security for our essential workforce, local pension funds need to broaden their asset class options. Private equity is one of these options.

Business Daily | 28 July 2023

How consumer needs are driving pension sector change in Kenya

Over the last two decades, pension assets have grown substantially under the Retirement Benefits Authority (RBA). The regulator has developed and amended pension schemes' regulations aimed at strengthening the legal and regulatory framework in the sector. The goal has been to achieve comprehensive pension coverage across the formal and informal sectors and better protect the interests of beneficiaries and the rights of pension contributors. As such, pension coverage has grown to about 22 percent of the labour force from 12 percent in the year 2000, with the industry coming second as the most preferred mode of saving.

While acknowledging growth and development in the sector, more still needs to be done to increase coverage in Kenya given that only about 3.5 million people out of the 27.1 million people in the workforce are in pension schemes. The bigger question is how this gap can be filled. The emerging factor that has been an influence of change over the last two decades has been consumer needs. The ever-changing consumer needs have catapulted changes such as the access rules to allow members before retirement to get up to a maximum of 50 percent of the total accrued pension benefits and the introduction of new asset classes.

The needs the pension sector is expected to meet continue to expand enormously, particularly, in the volatile markets. However, I believe there are other factors that are already gradually influencing change and ones that pension sector players can factor in as we seek to grow coverage. The latest wave of adults, Millennials and Gen-Z especially are the first generation with little or no experience of a pre-internet world, and the first to have been steeped in online media virtually all their lives.

However, compared to other generations, they face a series of difficulties in building wealth, due to the combined impact of rising cost of living, unemployment and higher rates of debt. These factors constrain their ability to save for retirement during their core earning years. However, their online mindset helps them a lot by staying informed and this is a factor pension players can take advantage of. Through the use of digital channels, we have the advantage of proactively communicating and engaging with this generation to better educate them on the need to save for retirement and in the same breath, listen to their needs and see how to address them.

Covid-19 threatened to reverse gains made over the past two decades. Global stock markets plunged significantly meaning that many pension pots shrunk and for many, their disposable income was reduced due to loss of jobs and salary cuts. As a result, more than three percent of contributors either reduced or suspended their contributions. Given the uncertainty of pandemics and experience, one key lesson was that pensions can provide a cushion in crises. The high levels of inflation, rising interest rates, and greater economic uncertainty are adding more financial pressure to the existing pension system and it is critical that we adjust pension offerings to meet the needs and expectations of our future communities.

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